RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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June 16, 1982 **LETTER 837**

June 4, DJIA 804.98; PTI 1353; A-D Ratio –26.42
June 11, DJIA 809.74; PTI 1340; A-D Ratio –26.51

THE PICTURE: Let's make a cold, unemotional appraisal of the picture on Wall Street at this time. From April, 1981 peaks of 1024.05 (D-J Industrials) and 446.59 (D-J Transports), the Averages turned down. A primary bear market was signaled on July 2, 1981, following which the decline accelerated. On March 8, 1982, the two Averages recorded extreme bear market lows of 795.47 for Industrials, 314.36 for Transports. A new advance then took the Averages to March highs (see chart below).

From the March peaks the Averages turned down again. On June 9 (last week) the Transports broke below their March lows. On June 10 Industrials plunged to 795.57, exactly .10 above their March 8 low. As long as Industrials hold above that March 8 low of 795.47, we will have a definite non-confirmation.

The non-confirmation came at the tail end of a most extraordinary series of down-days in the market. In fact, during the 23 days between May 11 and June 9, the advance-decline ratio declined 20 times. Now 20 out of 23 days of decline may not be a world record—but it is close! Off hand, I can't remember another period of 23 trading days when the market declined 87% of the time. So what we saw during that May-June period was an area of unbelievable downside compression—ending with a non-confirmation in the Averages.

Turning to the page 2 chart, note that the A-D ratio broke to a new low of minus 27.07 on June 9. And, although this has long-term bearish implications, for the near-term it is significant that the Dow did not confirm the new low in the A-D ratio.

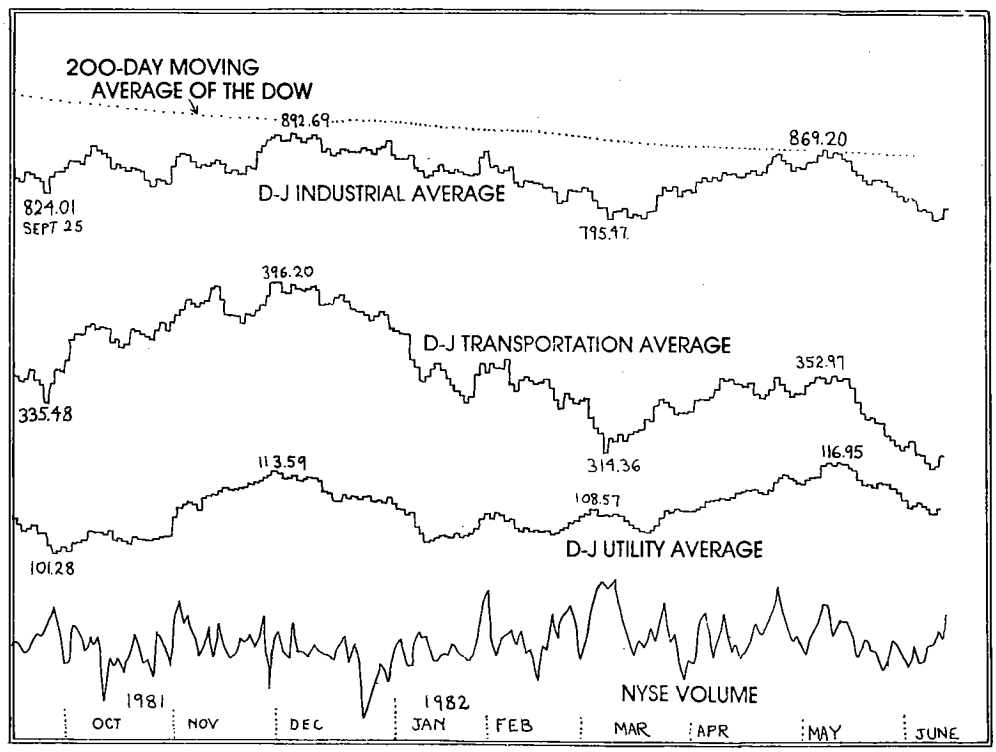
FRONT PAGE COMMENT: Economists love to label the times. We had the "Fabulous Fifties" and the "Soaring Sixties." Recently a subscriber asked me how I'd label the '80s. I immediately told him, if I had to label the 1980s, I'd call them "The decade of debt and default." And that, unfortunately, is the way I see it.

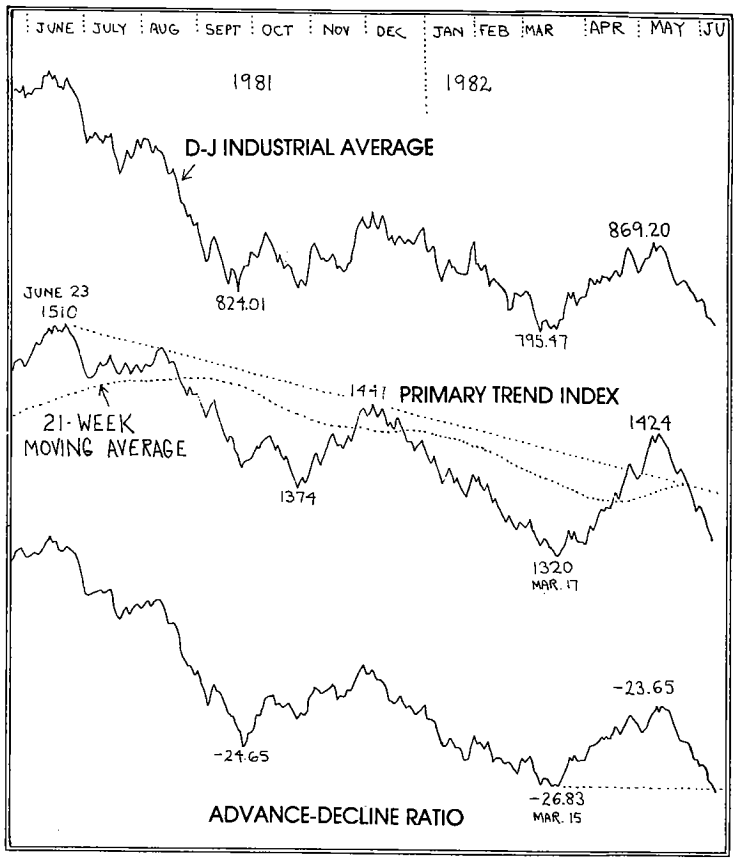
I've warned for years of the disastrous build up of debt and the compounding of that debt at increasingly higher interest rates. I warned that there could be only one result to come out of the debt explosion, and it would be bankruptcies and defaults. That's the period we are moving into now.

All debt must ultimately be (1) paid off, (2) reneged on, and we call this bankruptcy, or (3) rescheduled by desperate lenders. We are seeing all three processes at work now. We see it in US housing delinquencies, we see it in bankruptcy statistics, we see it in the so-called "non-performing loans" of the banks. And perhaps most frightening of all, we see it on the international scene. There is now $524 billion in external (international) debt. Today, no less than 25 nations are delinquent on their debt payments. The total of this delinquent debt has risen to $6.5 billion. Biggest current fear is that Argentina will renege on its $34 billion of foreign debt. The time bomb is ticking.

Further ammunition in favor of an upside reversal occurred in the high-low index. March 9, 1982 saw the peak in daily new lows on the NYSE at 263. The highest figure since then (despite the sagging A-D ratio) was 175, recorded on June 7. The easing of new lows implies a general easing of selling pressure.

Next, note on the page 2 chart that my Primary Trend Index (PTI) recorded its bear market low of 1320 on March 17. Following that low, the PTI rallied to a May 11 high of 1424. Between May 11 and June 9 the PTI dropped 93 points—without so much as an intermittent rally of 6 points! This was an amazing performance, and I don't think I have seen anything like it in the 12 year history of the PTI. Aside from the fact that the PTI failed to correct during a 93-point straight-line plunge, it also failed to break its March low





of 1320. Thus, the PTI has refused to confirm the new low in the A-D ratio, a rather unusual event.

It is also worth noting that neither the Standard & Poor 500, the NYSE Index, nor the D-J 65, or the Wilshire (all broad market guages) have broken to new bear market lows, despite the new low in breadth.

What is my conclusion? My conclusion is that the market is now drastically over-sold, as well as being bolstered by a series of non-confirmations (i.e., non-confirmations of the new bear market lows in the D-J Transporation Average and the A-D ratio). This "should" set the stage for a good rally.

Remember, my studies of the 233-day cycle indicate that the bull segment of the latest cycle (see Letter 835, page 4) will carry into late July. Thus, it seems to me that as long as the D-J Industrials hold above 795.47, the case can be made for a bear market rally which could last well into late July before the bearish segment of the 233-day cycle takes over and drives the market down again.

Glancing in the Russell crystal ball, I can see a period of rally which could easily turn into optimistic froth by mid to late July–all this to be followed in the fall by a new and violent down-phase in the bear market. In other words, just about the time public and the institutions believe that "the worst is over," the bear will come out of his lair again and take the market down (while a whole new crowd of snorting bulls takes its losses).

What does all this mean as far as readers of Dow Theory are concerned? For the great run of my investment-minded readers, nothing has changed. But for those who have been itching to trade, my suggestion would be to move speculative money into no-load funds, this position to be maintained (1) as long as the PTI holds above its March 17 low of 1320, (2) as long as the D-J Industrial Average holds above the 795.47 level, and finally (3) speculative positions may be held UNTIL I say otherwise, or until I say it's time to bail out. In other words, *if any one* of the three conditions are met, speculative positions in common stocks are to be jettisoned.

Question: Russell, I thought you said that you disapproved of trying to beat a bear market with long positions? What gives?

Answer: After 20 out of 23 days of decline followed by a down-side non-confirmation, we have a relatively "safe" entry point for traders. We also have *very close and easily recognizable exit points.* In view of this, I am saying that we have a favorable risk-reward situation for traders. Such situations are rare in any market, and I'm pointing this one out. It's up to those of you who know yourself and who know the odds involved to make your own decision.

I note that all during this bear market the great majority of advisory services have been recommending various "selective" stocks to buy. Purchase of those shares has, in general, proved to be disastrous.

More recently, putting out shorts and buying puts has proved to be very popular. My guess is that the put buyers and short sellers could be facing a few losses of their own over the next month or so. Pessimism has become too easy, too chic.

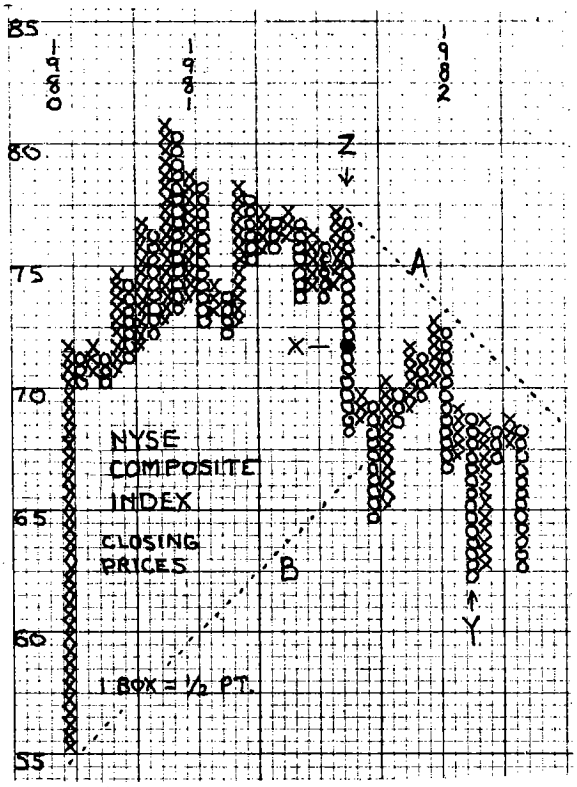
So I have my own intuition backed by a good deal of technical evidence. I feel (keeping the three above-mentioned strictures firmly in mind) that the bears may have had enough fun for a while, that the bulls may now have their own inning, and that the put buyers and short sellers may (at least for a month or so) be driven to the wall. Remember, all's fair in love and in the markets.

INVESTMENT POSITION: There's a long-term bear still lurking on Wall Street, but because of the situation explained earlier, I'm going to put the bear back in his lair for a while. For patient long-term investors, little has changed. Sit tight with T-bills. There'll be plenty of them available, since Uncle Sam has to raise $90 billion in NEW money over the next six months.

For traders and the more venturesome, I personally like making money with no-load funds. I've recommended that you keep small amounts in good funds with switch capabilities so that at the proper time money could be transferred to such funds. There are many funds that offer such features such as the Neuberger Berman group, the Vanguard group, the Federated group, the Fidelity group.

Of individual stocks, the following make up an interesting speculative package: Cluett Peabody, Marshall Field, Super-markets General, E Systems, Eli Lilly, R.H. Macy, Spring Mills, Texas Utilities.

SPECIAL STUDY: This is my point & figure chart of the NYSE Index, a very broad Index covering aggregate values of all NYSE issues. This is a half-point chart (each box equals one-half point) and only rallies and declines of 1.5 points or more are shown.



The Index formed a huge top during 1980-81. In August of '81 the Index turned ominously bearish (point X on chart) when it broke below all previous bottoms. The Index then smashed to a low of 65 in September. From the 65 level a rally took place, but the rally was held in check by bearish trendline A. Following the rally to the 73 level, a new decline took the Index to a low of 62.5 (point Y) in March, 1982.

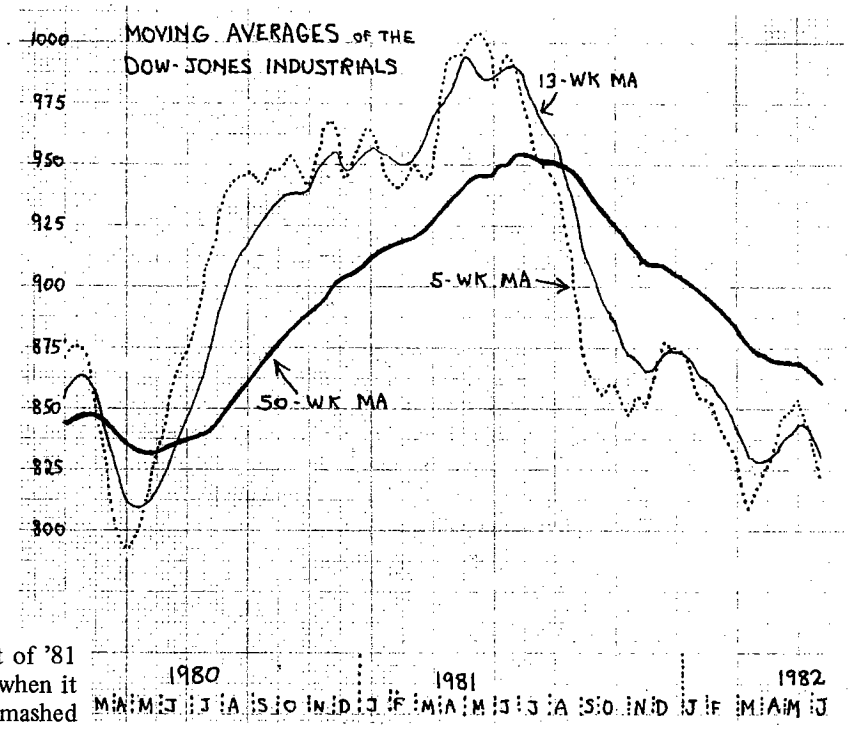
A new rally occurred, but again bearish trendline A held the rally in check. In May the Index again turned down. The latest decline has taken the Index to the 63 box. Note that all of 1982s action has occurred (1)below trendline B, a major bullish trendline that has now been ruptured, and (2) below trendline A, which is the major bearish trendline now in force. Thus, the chart shows that the bear is firmly in command of the NYSE Index–from a long-term standpoint.

Of interest at this time is the measuring or projection properties of point & figure analysis. One method of measuring is based on the thesis that the INITIAL THRUST of a movement provides information as to the ultimate target for that movement. For instance, in the current situation the initial plunge from the top formation (vertical row Z) consumed 18 boxes. Since each box represents half a point, this was a 9 point drop in the NYSE Index. For measuring purposes (since this is a 3-box reversal chart) we multiply the 9 points by 3, giving us 27. Then we subtract the 27 from the level from which the decline began–which was 77.5. This gives us an ultimate target of 50.5 on the NYSE Index. Translated into Dow points, this provides us with a target of about 640 on the Dow.

QUESTION: How reliable are P & F projections or targets?

ANSWER: I would say that most projections, properly interpreted, will work out. I use *long-term* projections simply as reference targets. The target stands as long as I believe that the primary trend is intact–and in the direction of the ultimate target price. In other words, the most reliable projections tend to be *in the direction of the prevailing primary trend* (I don't trust projections that are against the primary trend of the market, such as an upside target within a bear market).

It is also important to remember that these projections entail the long term. Over the short or intermediate term, anything can happen–and usually does.



MOVING AVERAGES: Veteran subscribers know that I have always placed the greatest emphasis on the *action* of the stock market (rather than the so-called sentiment indicators). I trust the action of the market above all. In my experience, I have found that the market action is most likely to be "honest," it is most likely to be definitive. The fact is that all the other studies (i.e., odd lots, short interest, insider buying and selling, margin accounts, etc.) are followed in an effort to understand and predict forthcoming market action. Why not study the market action itself? And that is what I do (or at least that is where I place my greatest effort).

One of the studies which I have found valuable is the three moving averages of the Dow. I run a long-term or 50-week MA, an intermediate or 13-week MA and a 5-week or short-term MA. The action and relative position of these three moving averages, when properly interpreted, can tell us a lot about the Dow.

It is important to remember that the moving averages must always be interpreted with the direction of the primary trend in mind. Right now, according to Dow Theory, the primary trend of the market is bearish–it's down. Until that changes, I give greatest credence to any *downside* movement of the Dow and its three moving averages (obviously, when a bull signal is given I then give greatest credence to upside movements).

Referring to the chart, note that following an upward spike, the 5-week MA broke decisively below the 13-week MA on the week of July 2, 1981 (A on the chart). This was the initial danger signal under the moving average study. And this initial break occurred during the same week that the Dow Theory issued its primary bear market signal.

On the week of August 28, the 13-week MA plunged below the 50-week MA. This was a major bearish signal, and if there was any doubt about the earlier signal at point A, this second signal at point B should have laid all doubt to rest.

From that point on, I asked myself these questions: (1) Is the 50-week or primary MA continuing to fall? If so, it is reasonable to assume that the primary bear trend remains in force. (2) Is the 13-week MA making an irregular series of new lows? As long as that condition continues, it is certain that the primary trend is in force. (3) Is the more erratic 5-week (short-term) MA tending to hold BELOW the 13-week MA? And is each sporadic rally in the 5-week MA followed by a plunge to new lows? Such action (typical of a bear market) tells the student that the primary trend of the stock market continues to be down.

During a primary bear market each of the three MAs provides increasing RESISTANCE to a market rally. For instance, the 5-week MA for the Dow stands at 840. This is, therefore, a resistance area for rallies in the Dow. The 13-week MA stands at 841, thus doubling the resistance power of that level. The 50-week MA stands at 865, and only the most powerful bear market rally should reach the 865 level.

We have a "marker level" in that the low for 5-week MA was touched on the week of March 19 at 810. Thus, I will be watching to see if the Dow falls below the 815 level and stays below that level. If the Dow falls below 810 and *holds below 810*, I know that in time the 5-week MA will break to a new bear market low. Such action (under the moving average study) would constitute a reconfirmation of the bear trend. On the other hand, a persistent refusal by the Dow to hold below 810 could be telling us that better things are ahead.

I want to close this discussion with one comment: As far as stock market studies are concerned, it is more important to know and understand a single indicator thoroughly than it is to have a scattering of knowledge (as most analysts do) about a lot of studies. One indicator which is thoroughly understood is worth a hundred indicators that are casually watched.

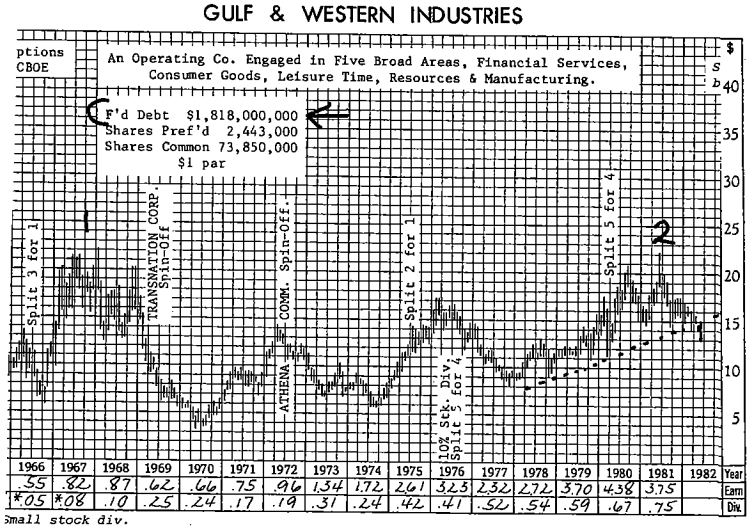
THOUGHTS: There's a fellow who lives a couple of blocks north of me named Dick Cramer. He's smart as a whip. A while back, at a party, I played an assortment of games with him. He beat the hell out of me in every game. He's brilliant–and competitive. About 10 years ago, Cramer started a company called IMED. The Company makes volumetric intra-venous medical devices and it has done fantastically well. Last year IMED earned $20 million net. And last week Dick Cramer announced he was selling IMED in probably the largest sale of a private company in US history. Warner-Lambert is buying IMED for cash. They're paying $465 million (that's right, $465,000,000) for IMED!

As I said, I think Cramer's a genius. And I think Warner-Lambert is a fool. I don't care how good IMED is, Warner is paying $465 million for $20 million in earnings. Where will Warner get the cash? Who knows? The banks, some of their own cash, I don't know. All I do know is that if I were Warner-Lambert I'd put aside $20 or $30 million and start my own division, I wouldn't put up half a billion in cash. But it's a sign of the times. It's a case of corporations (to my mind) acting like damn fools with the stockholder's money.

Now I watch a lot of things on Wall Street. For instance, I watch Gulf & Western, and I note they have a whopping $1.8 billion in debt. I read in the June 10 WSJ that G & W is buying an additional $3.6 million in Bank of New York stock. They're doing this even while their own stock is sinking to new lows below 13. I look at the long-term chart of GW, and I see that the stock has a long-term double top in the 23 area, and that it has just broken down below a 5-year trendline. And I say, "Mmmm, I wonder what these guys are thinking of? They have $1.8 billion in debt, their stock is breaking to new lows and they're putting out cash to buy more bank stock. Good luck."

Last week I also read where Mr. Bronfman of Seagrams is boasting that he bought 20% of duPont and he thinks he probably should have bought more. He paid about $50 a share for duPont, although the shares are selling for $32 today. And I look at the duPont chart, and I note that this once conservative company now has $6.7 billion in funded debt. And I look at the chart of duPont, and you can see that the stock is in maybe the biggest descending triangle in recorded history. "And what happens if DD breaks below support at 29?" I ask myself. The chart says that a break below 29 would make DD a disaster, a technical "basket case." And I wonder, how smart was Bronfman? He may be a blasted genius, but the chart tells me he's going to sweat with DD before the 1980s are over. And you know, there are a lot of stocks like DD and GW around. And there are a lot of banks who have lent them money.

GULF & WESTERN INDUSTRIES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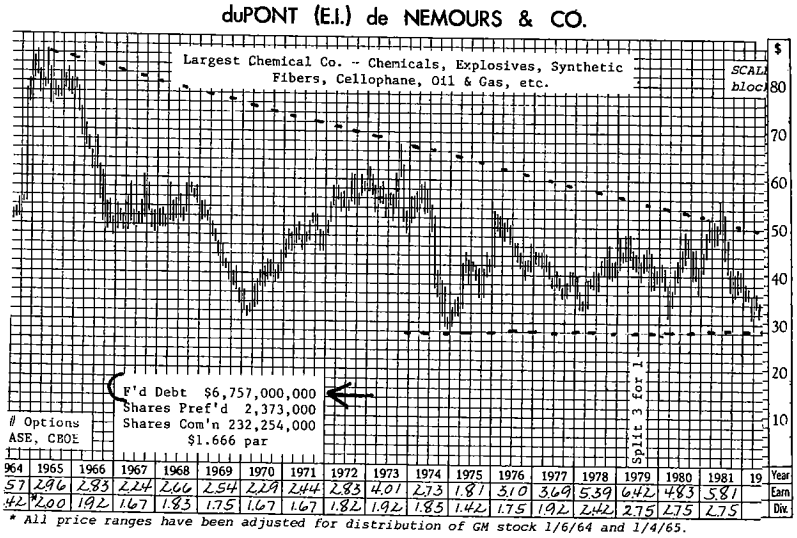


* All price ranges have been adjusted for distribution of GM stock 1/6/64 and 1/4/65.

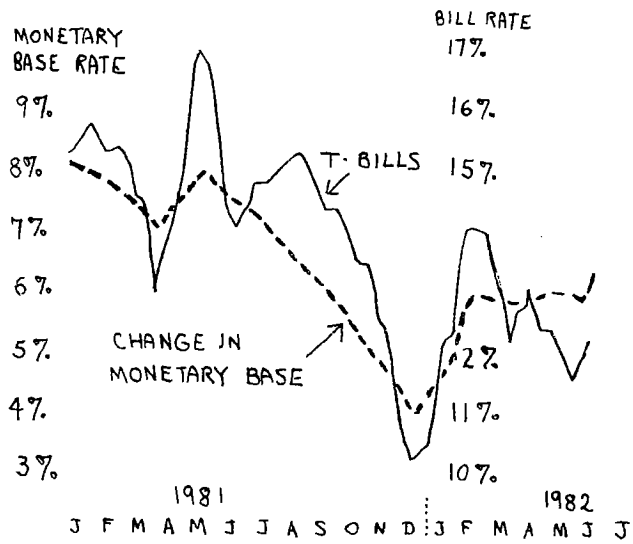
But you know me by now, dear readers; Russell is just a chronic worrier, and everything will undoubtedly work out in the end. (chart courtesy of Horsey, Salisbury, MD 21801.)

MONEY: The latest figures show that the US national debt has risen to $1.07 trillion dollars, up a cool $70 billion dollars since September (remember just some months ago when the debt climbed over $1 trillion for the first time?).

Here's the way the new borrowing is coming through, according to the authoritative Schroder Report (J. Henry Schroder Bank & Trust). During July through December, 1981, the Treasury borrowed $59.5 billion. For July through December, 1982, the report sees borrowing (new money to be raised) of about $90 billion. And remember, this is just Federal borrowing, not state or corporate.

QUESTION: Why can't the Fed increase the money supply and thereby bring down interest rates?

ANSWER: They can try, but I don't think it would work. The money market is now sophisticated and extremely sensitive to any Fed attempt to gun the economy by booming the money supply. This chart shows the year-to-year change in the monetary base. The 91-day T-bill rate is also shown. Note that when the



rate of change in the monetary base rises, the T-bill rate also rises. Thus, any attempt by the Fed to greatly expand the monetary base would simply drive interest rates up as well. Booming the monetary base would simply push interest rates to new highs, thereby frustrating the intentions of the Fed (note: the monetary base statistics used are adjusted reserve figures as published by the St. Louis Federal Reserve Bank).

The demands on the money market will be tremendous during the rest of 1982. Corporations will be raising about $100 billion, on top of the $90 billion needed by the Treasury. As I stated in the last Letter, I believe we're looking at the end of the rally in bonds. From here on, it's going to be rough sledding in the money market. And it could be considerably rougher than most people believe.

QUESTIONS & ANSWERS: Russell, I've heard rumors that the US Government is planning to call in all paper money and issue new currency at the rate of one "new" dollar for every 10 of the old ones. Is this true?

ANSWER: This is a story that has been kicking around for years, and it has been used as an advertising eye-catcher by the venerable Franz Pick. I believe the story is so much rot. First of all, the US Government may mess around with our money in a gradual way (inflation), but they wouldn't upset the apple-cart by making a huge change all at once.

Second, you saw what happened when the Susan B. Anthony silver dollar was introduced. The people wouldn't touch it, and the Treasury ended up "eating" millions of those turkeys. Imagine what would happen if the Treasury tried to change the currency completely–you'd have a revolution.

Third, an inverse switch (i.e., one red dollar for every 10 of the green ones) would not accomplish a thing. Ostensibly, the switch would be an attempt by the Government to wipe out the appearance of inflation. But in reality, it would solve nothing. The "big switch" concept has been a favorite of the hard-money boys for years. Well, I'm still taking in greenbacks for subscriptions, and I can still buy an "all you can eat" dinner here in San Diego for $7 or less.

My advice: Don't worry about an inverse switch for your dollars, just concentrate on making and investing those lowly dollars.

QUESTION: What do you think of the new stock index futures such as the Value Line futures?

ANSWER: These futures can be used for two purposes: (1) as a legitimate hedge for a portfolio, or (2) as speculations on the trend of the market. My immediate initial comment is that buyers of these future contracts will tend to lose their money. They'll lose their money for the exact same reason that the majority of speculators tend to lose their money in the stock market. The reasons for failure are faulty judgment, psychological strain, deceptive market movements, and the fact that commissions are stacked against you (versus, for instance, trading no-loan funds where at least you don't have to contend with commissions).

My opinion about the futures for the vast majority of subscribers is–forget them. Concentrate on the basics of correct investing, concentrate on being correctly positioned (fully invested) during bull markets and correctly positioned (on the sidelines) in bear markets, and you'll be way ahead of the game.

"But why not clean up by playing the trend with futures?" you ask. The answer is that many people can make cold, unemotional appraisals of the trend as long as their assets are not involved. But when their money is on the line, the pressure of daily news, minor price bounces, psychological pressures, all militate against success. On top of this, most futures are purchased on thin margin, and this leverage greatly intensifies the psychological pressure. Thus, when the market goes against one (assuming he is in futures) the speculator loses sleep, he starts adding up his paper losses, and he loses his equanimity. Ultimately, the odds are that he will be knocked out of his contract–with losses.

Conclusion: For 80% of my subscribers my advice is–forget the stock index futures. For the 20% who are pros–you don't need my advice or my warnings: you are the subscribers I don't worry about (I estimate that 20% of my subscribers are professionals, NYSE members, brokers, money managers or seasoned businessmen).

NOTES & QUOTES: Despite what you may have heard, every boom in modern history has been a capital goods boom (the real booms in the economy are created by heavy industry expansion, not consumer buying). Along these lines it is disconcerting to note the current slump in capital goods stocks. The 52-week new low list is now dotted with capital good stocks, stocks such as Caterpillar Tractor, Brown & Sharpe, Deere, Dravo, Dresser Industries, Gleason Works, Harnischfeger, Ogden, Rexnord, Stanley Works. The dismal fact is that corporate planners are calling off, cutting back, discontinuing capital goods expansion programs. That means–no boom in the forseeable future.

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Bear markets don't respect very much–least of all glamor stocks. *Financial World* in its June 1 issue offered a run-down for various categories of "high tech" issues. Here are some statistics (based on percentage changes from their 1981 highs). Computer and softwear stocks down 49%. Semiconductor components down 43%. Telecommunications down 35%. Defense electronics down 39%. Minicomputers down 58%. Biogenetics down 32%. Robotics ("the industry of the future") down 54%.

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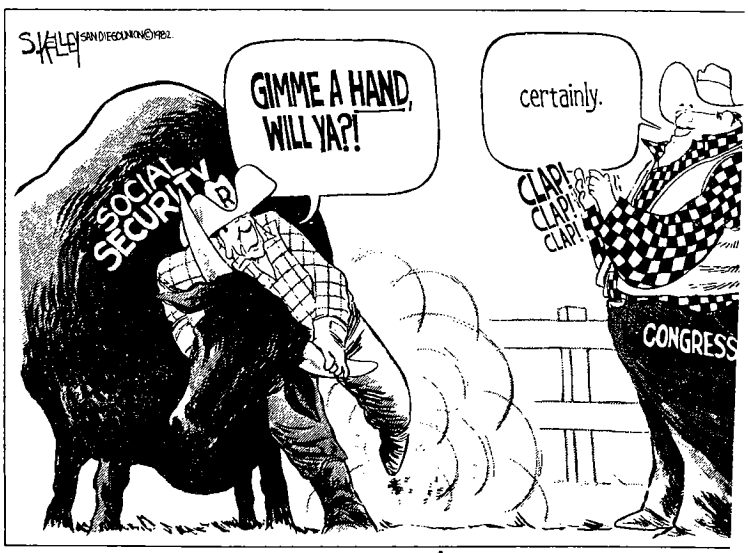
At least one cartoonist is sympathizing with Ronnie's plight. But it's all OK on Social Security–the whole mess has been put off until 1983. Our boys in Washington will solve it then.



GOLD, SILVER: I continue to believe (contrary to most of my friends in this business) that the March low of 312.50 was probably the bear market low for gold. True, four shooting wars all going on at the same time have not really moved gold up. But on the other hand, new lows in the CRB Commodity Index, plus crashing copper, silver, and palladium have not broken gold to new lows.

Back in 1979-80 I did pretty well buying Canadian "cheapie" gold shares, such as the ones pictured on these charts. I sold them near the top for good profits. Since late-1980, the Canadian golds have gone through their version of 1929-32, and that's no exaggeration. These charts are TYPICAL of what's been happening to the Canadian speculative gold shares. I mean these prices have plunged 85%, 90% and more. Stocks that were selling at 10 and 15 in Canadian dollars are now selling below a dollar. Fortunes were made in these shares on the upside and fortunes were lost on the downside.

Will they ever take off again? Probably. Are they a buy here? Darned if I know. But they won't move until gold does. You can get a single issue of the Canadian Mining and Oil Stock Chart book ($20) from Box 10334, Pacific Centre, Vancouver BC V7Y 1G5. Glancing through this book of hundreds of Canadian mining and oil shares is an education–in disaster. But as the Chinese say–out of disaster comes opportunity.

In the meantime, the moving averages for gold remain in the bearish mode. The 5-week MA for gold stands at 327, the 13-week MA stands at 338 and the 50-week MA is at 389. But note that gold is now tending to bounce above its 5-week MA. And gold momentum is looking more interesting. I think gold is beginning to look more interesting. But I'm still not buying.

LATE NOTES: Remember, nothing's changed, not the economy, the fundamentals, the deficits, the primary trend of the market. But the market did get over-sold on its way down to the June 9 low–and that gave way to "the big bounce." I would think that the rally would carry considerably further. There were just too many amateur speculators trying to make a killing on the bear side. But the bear hates people making money on his back, and periodically he stops and shakes 'em off. We're in that kind of period now. If you're loaded with puts or shorts, happy landings.

NEXT MAILING: June 30, 1982